Supreme Court, U. S.
FILED
JUL 18 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1630

TITAN GROUP, INC.,

Petitioner,

against

HAROLD FAGGEN,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BURTON S. COOPER
Attorney for Respondent
235 East 42nd Street
New York, New York 10017
(212) 687-8800

Of Counsel:

SHEIB, SHATZKIN & COOPER
EDWARD LABATON
JOEL C. FEFFER

TABLE OF CONTENTS

	PAGE
Reasons for Denial of Certiorari	3
POINT I—This Court should not review a dismissal of petitioner's private damage claim of Rule 10b-5 fraud where the Courts below properly examined the transaction in light of the surrounding circumstances	4
POINT II—The acceleration of the debentures by virtue of the default in the payment of interest was proper	10
Conclusion	10

TABLE OF CASES

Affiliated Ute Citizens v. *United States*, 406 U.S. 128 (1972)	6, 7, 8
Arber v. *Essex Wire Corp.*, 490 F.2d 414 (6th Cir.), cert. denied 419 U.S. 830 (1974)	7
Chris Craft Industries, Inc. v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), cert. denied 414 U.S. 910 (1973)	8
City National Bank v. *Vanderboom*, 422 F.2d 221 (8th Cir.), cert. denied, 399 U.S. 905 (1970)	7
Clement A. Evans & Co. v. *McAlpine*, 434 F.2d 100 (5th Cir. 1970), cert. denied, 402 U.S. 988 (1971)	7
Competitive Associates, Inc. v. *Laventhol, Krekstein, Horwath & Horwath*, CCH Fed. Sec. L. Rep. ¶ 95,090 (2d Cir. May 8, 1975)	8, 9

PAGE

Financial Indus. Fund, Inc. v. *McDonnell Douglas Corp.*, 474 F.2d 514 (10th Cir.), cert. denied, 414 U.S. 874 (1973) 7

Kohler v. *Kohler Co.*, 208 F.Supp. 808 (E.D. Wisc. 1962), aff'd, 319 F.2d 634 (7th Cir. 1963) 7

Kohner v. *Wechsler*, CCH Fed. Sec. L. Rep. ¶ 93,537 (S.D.N.Y. June 10, 1972), aff'd as modified 477 F.2d 666 (2d Cir. 1973) 7

Landy v. *Federal Deposit Insurance Corp.*, 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974) 7

Lewis v. *Dansker*, 357 F.Supp. 636 (S.D.N.Y. 1973) .. 8

List v. *Fashion Park, Inc.*, 340 F.2d 457 (2d Cir.), cert. denied, 382 U.S. 811 (1965) 7

Metro-Goldwyn-Mayer v. *Ross*, 509 F.2d 930 (2d Cir. 1975) 8, 9

Ply-Gem Industries, Inc. v. *Green*, CCH Fed. Sec. L. Rep. ¶ 94,026 (S.D.N.Y. June 15, 1973), aff'd and rem., 503 F.2d 1362 (2d Cir. 1974) 7

Robinson v. *Cupples Container Co.*, 513 F.2d 1274 (9th Cir. 1975) 7, 8

Vohs v. *Dickson*, 495 F.2d 607 (5th Cir. 1974) 7

STATUTE CITED

Securities Exchange Act of 1934, Rule 10b-5 . . 2, 3, 4, 6, 8, 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1630

TITAN GROUP, INC.,

Petitioner,

against

HAROLD FAGGEN,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

This action was commenced three and one-half years after the execution of meticulously drafted contracts containing Respondent's detailed financial representations and warranties, pursuant to which contracts Petitioner acquired from Respondent four highly profitable actuarial consulting companies (the "Faggen Companies"). In its proxy statement filed with the Securities and Exchange Commission and disseminated to its shareholders six months after the closing, Petitioner acknowledged that the transaction was conducted at arm's-length and that the financial and other affairs of the Faggen Companies had been thoroughly investigated (Def. Ex. D, R. 1542).* In exchange for the

* As used herein "R" refers to the appendix before the Court of Appeals; "Pet." refers to the Petition for a Writ of Certiorari; and "Pet. A" refers to the appendices to such Petition.

Faggen Companies, Petitioner delivered to Respondent convertible subordinated debentures in the principal amount of $5,500,000 with interest at 4% per annum and with amortization of principal to occur between the sixth and tenth years.

Before having made any payment on account of principal, and after the Petitioner had withdrawn more than $2,000,000 in cash and marketable securities from the Faggen Companies, Petitioner defaulted in its interest payment and simultaneously commenced this action to rescind the transaction, alleging that there were fraudulent misrepresentations and omissions in violation of Rule 10b-5 under the Securities Exchange Act of 1934 (17 C.F.R. 240.10b-5). These alleged misrepresentations and omissions did not relate to the contract documents themselves but to a memorandum delivered two months prior thereto. The Respondent counterclaimed on the debentures which, by their terms, were accelerated by virtue of the default.

The United States District Court for the Southern District of New York, Harold R. Tyler, J., in dismissing the complaint after trial and awarding judgment to Respondent on his counterclaim, held that Respondent had made no misrepresentation and did not omit to state any material fact. The Court of Appeals for the Second Circuit (Waterman, Oakes and Gurfein, JJ.) unanimously affirmed. Rehearing and rehearing en banc were denied. Petitioner now seeks review of these determinations claiming that the factual findings were erroneous because the courts failed to apply the proper standards of reliance and materiality to the aforesaid memorandum. The facts relating to this case are fully detailed in the opinions below.

Notwithstanding the Trial Court's express factual findings to the contrary and the affirmance by the Court of Appeals of those findings, Petitioner in disregard of those findings continues to assert that Respondent omitted to disclose a loss of clients, by virtue of which Petitioner purchased a "shrinking business" (Pet. 4, 5),* and that Respondent omitted to disclose the assumptions upon which the adjusted earnings were based (Pet. 5, 7). As to both contentions which relate only to issues of fact and not to questions of law, the Courts below found for Respondent (Pet. A 5a-7a, 15a, 19a, 20a, 31a-34a).

Reasons for Denial of Certiorari

1—This Court should not review factual findings, affirmed by the Court of Appeals, that Respondent made no false statement and did not omit to state any material fact necessary to make the statements made not misleading.

2—This Court should not accede to Petitioner's request to rewrite Rule 10b-5(2) so as to bar the presently required

---

* Petitioner does more than disregard the findings. It actually distorts the record. Thus, it states: "Undisputed evidence showed a $386,922 shrinkage (40%) of the $1 million gross actuarial business of the Faggen Companies between 1966 and 1973" (Pet. 6). The undisputed evidence is directly to the contrary. The President of Petitioner's actuarial division testified that in 1969 the company acquired a single client whose volume exceeded $250,000 and that the gross actuarial business of the Faggen Companies did *not* shrink (R. 811, 819-20). This testimony was summarized in one question and answer:

> The Court: And if I also understand your testimony, though it is true in this period of time, those years, you lost about forty clients, it did not have any great impact upon the gross or the volume, to use your word, partly because you picked up one new client which practically absorbed or virtually came close to absorbing the loss of billings or volume which went out with the forty?
>
> The Witness: Yes.

(R. 819-20)

Petitioner's so-called "undisputed evidence" consists of a list of clients lost in the eight years from 1966 to 1973, inclusive, three years before and five years after acquisition, but fails to include any new clients gained in the same period. Yet the person who on Petitioner's behalf prepared that list, testified that "like any other business, there were clients gained [and] clients lost" by the Faggen Companies during those years (R. 793).

inquiry into the particular circumstances of a transaction in determining the materiality of the alleged omissions, for to do so would reverse an unbroken line of cases requiring a plaintiff to establish causation in fact as a necessary element in a Rule 10b-5 claim.

3—This Court should not review a judgment for the principal amount of debentures properly accelerated by Petitioner's default.

POINT I

This Court should not review a dismissal of petitioner's private damage claim of Rule 10b-5 fraud where the Courts below properly examined the transaction in light of the surrounding circumstances.

The Trial Court found, and the Court of Appeals affirmed, that Petitioner failed to prove, as Rule 10b-5(2) requires, that Respondent had made a misleading statement or omitted "to state a material fact, necessary in order to make the statements made, *in the light of the circumstances under which they were made,* not misleading."

As to each of Petitioner's factual contentions in its Petition, the trial Court found and the Court of Appeals affirmed that there had been no shrinking business, that the memorandum of adjusted earnings was reasonable and that Petitioner was aware of the assumptions underlying the adjustments (Pet. A 4a-6a).

Notwithstanding these express factual findings against it, and the plain language of Rule 10b-5, Petitioner argues that Judge Tyler should have ignored the circumstances of the transaction* and instead should have found, and the

* Petitioner contends that the Court may not consider the "circumstances" of the transaction in determining the materiality of an

(*footnote continued on following page*)

Court of Appeals should have affirmed, that there was a shrinking business, that the adjusted earnings were not reasonable and that the basis for the adjustments was not disclosed—that somehow the courts below would have made such findings if, instead of judging the Petitioner in the light of the circumstances surrounding this transaction, they had substituted for the Petitioner a hypothetical "reasonable investor".

In egregious unconcern for the record, but as a make weight for its argument that a different factual finding would have resulted if the hypothetical "reasonable investor" had been substituted for Petitioner, Petitioner now, for the first time, accuses Judge Tyler of making his findings on the basis of his "prejudicial opinions of small conglomerates, circa 1968, and their particular negotiating agents" (Pet. 18). Petitioner makes not a single record reference in support of this startling accusation. It never made any such accusation before the Court of Appeals and in making such accusation before this Court it implies that the Court of Appeals was likewise so moved since that Court found that there was abundant record evidence to support Judge Tyler's findings.

Notwithstanding the indefensible charge against the courts below, the substitution of the "reasonable investor" for the Petitioner would not have changed the facts that there was no shrinking business, the adjusted earnings were reasonable and Respondent disclosed the assumptions upon which the adjusted earnings were based.

Finally, it is frivolous for Petitioner to suggest that the substitution of a "reasonable investor" for the actual

(*footnote continued from preceding page*)

omission; that the Court of Appeals supplanted "objective materiality" with "circumstances" (Pet. 18) that it was improper for the trial court to attempt to reconstruct the "circumstances" of the omission (Pet. 19); and that the Court of Appeals substituted the "uncertain doctrine of 'circumstances' " for an "objective rule of law". (Pet. 5)

investor would eliminate the potential for a trial Court's prejudice. Disregarding for the moment the plain language of Rule 10b-5, the substitution by the Court of its own "reasonable investor" judgment in all cases, regardless of the circumstances, would open wide the doors to the very potential which Petitioner ostensibly seeks to avoid. Rule 10b-5 requires a factual determination in light of the circumstances surrounding the transaction and that means making a determination based upon the parties to the transaction as well as the transaction itself. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972), did not rewrite Rule 10b-5 to eliminate the requirement of an examination into such circumstances, it simply permitted resort to a fictional "reasonable investor" where proof of reliance with respect to a particular investor was difficult. To suggest that what *Affiliated Ute* intended was to substitute the "reasonable investor" in all cases regardless of the circumstances is to suggest that the "circumstances" language of Rule 10b-5 is meaningless.

Implicit in Petitioner's contention that the Court below erred in considering the materiality of the alleged omissions applicable to the Petitioner, rather than to some hypothetical "reasonable investor", is the suggestion that, in determining who that "reasonable investor" was, the Courts should have ignored the sophistication or knowledge of the parties.

The materiality requirement of a Rule 10b-5 fraud case requires the court to examine the circumstances and to reject the notion that the transaction, or the parties, be examined in a vacuum. Consequently, where the parties are sophisticated, have business experience and expertise, are acquainted with the affairs of the corporation whose securities they purchase, and have access to the information alleged to be misrepresented, the Courts have consistently inquired into the materiality to the particular investor of the alleged misrepresentations and omissions,

and have generally denied relief in the absence of strong affirmative proof by the plaintiff that the particular misstatement or omission complained of was material to such plaintiff. Such cases include: *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2d Cir.) cert. denied, 382 U.S. 811 (1965); *Kohner* v. *Wechsler,* CCH Fed. Sec. L. Rep. ¶ 93,537 (S.D.N.Y. June 10, 1972), aff'd as modified, 477 F.2d 666 (2d Cir. 1973); *Ply-Gem Indus., Inc.* v. *Green,* CCH Fed. Sec. L. Rep. ¶ 94,026 (S.D.N.Y. June 15, 1973), aff'd and rem., 503 F.2d 1362 (2d Cir. 1974); *Kohler* v. *Kohler Co.,* 208 F.Supp. 808 (E.D. Wisc. 1962), aff'd, 319 F.2d 634 (7th Cir. 1963); *City National Bank* v. *Vanderboom,* 422 F.2d 221 (8th Cir.), cert. denied, 399 U.S. 905 (1970); *Clement A. Evans & Co.* v. *McAlpine,* 434 F.2d 100 (5th Cir. 1970), cert. denied, 402 U.S. 988 (1971); *Robinson* v. *Cupples Container Co.,* 513 F.2d 1274 (9th Cir. 1975); *Financial Indus. Fund, Inc.* v. *McDonnell Douglas Corp.,* 474 F.2d 514 (10th Cir.), cert. denied, 414 U.S. 874 (1973); *Landy* v. *Federal Deposit Insurance Corp.,* 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974); and *Arber* v. *Essex Wire Corp.,* 490 F.2d 414 (6th Cir.), cert. denied, 419 U.S. 830 (1974); *Vohs* v. *Dickson,* 495 F.2d 607 (5th Cir. 1974).

What is material to an unsophisticated investor (as in *Affiliated Ute*) may not be to a conglomerate corporation. See *Arber* v. *Essex Wire Corporation, supra,* and *Robinson* v. *Cupples Container Co., supra.* In contradiction of the authorities cited in the paragraph above, Petitioner argues that materiality cannot vary with the circumstances of the particular transaction or the parties thereto—that a statement or omission from a document is or is not material, regardless of the sophistication of the parties or the events which preceded the delivery of the document in question or the conversations that related thereto or the investigation that followed the document or the contractual

representations that ultimately were made. Materiality, Petitioner claims, is a matter of law (Pet. 5).

While materiality may be a rule of law, what is material is a question of fact (see, e.g., *Robinson* v. *Cupples, Container Co., supra; Lewis* v. *Dansker,* 357 F.Supp. 636, 642 (S.D.N.Y. 1973). Omissions are never material as a matter of law until their materiality has been factually determined.

As the Court below observed (Pet. A 7a-8a), causation in fact is a fundamental element in a Rule 10b-5 private action. Causation is established by materiality and, in appropriate cases, reliance.

Contrary to Petitioner's contention (Pet. 10), there is nothing novel in Judge Waterman's statement (Pet. A 7a) that *Affiliated Ute* did not abolish reliance as a prerequisite to recovery and that only where proof of reliance was difficult as a practical matter did *Affiliated Ute* authorize proof of materiality in lieu thereof. See *Chris Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341, 374 (2d Cir. 1973), cert. denied, 414 U.S. 910 (1973).

The Court of Appeals rejected Petitioner's contention that *Affiliated Ute* eliminated reliance as an element in all Rule 10b-5 actions involving omissions of material fact (Pet. A 7a). Having lost that argument, Petitioner now asserts, contrary to Rule 10b-5 and the aforementioned authorities, that, because it should have been judged as a "reasonable investor", instead of what it was, it was not even required to prove materiality in the circumstances of its case (Pet. 5, 18, 20, 21).

Petitioner asserts that Judge Waterman's opinion is inconsistent with two recent opinions in the Second Circuit—*Competitive Associates, Inc.* v. *Laventhol, Krekstein, Horwath & Horwath,* CCH Fed. Sec. L. Rep. ¶ 95,090 (2d Cir. May 8, 1975) and *Metro-Goldwyn-Mayer* v. *Ross,* 509 F.2d 930 (2d Cir. 1975). These opinions were brought to

the attention of the panel which decided this case, both before the opinion was rendered and thereafter in the petition for rehearing or rehearing *en banc.*

The *Competitive Associates* and *Metro-Goldwyn-Mayer* opinions are clearly consistent with, and indeed support, the Court's decision in this case. *Competitive Associates* reversed a decision granting summary judgment because the District Court "was premature in denying [plaintiff] an opportunity to prove its claims" (CCH p. 97,866) and remanded the case for trial, holding that the plaintiff was required to prove causation in fact and to "allege that it would not have acted as it did had it known of the information withheld by defendants" (CCH p. 97,865). The Court did not hold that plaintiff would recover even if it failed to prove the allegation—if it could not establish causation in fact. Yet, that is what Petitioner seeks here, for in this case Petitioner failed to prove the allegations in its complaint.

Contrary to Petitioner's assertion, *Metro-Goldwyn-Mayer* v. *Ross, supra,* was not a legally identical situation to the case at bar; there the District Court found an omitted fact to be material (509 F.2d at 933), but nevertheless rejected plaintiff's claim for rescission. In the instant case, the District Court found no material omission. In *Metro-Goldwyn-Mayer,* the Court of Appeals reversed on the strength of the materiality of the omission combined with a breach of a contractual representation in the exchange agreement. Here, the Court of Appeals affirmed—because there was neither a material omission nor breach of any contractual representation.

Finally, Petitioner's argument that the Court of Appeals excluded "all disclosure accounting principles from this case" (Pet. 19) is a distortion of the Court's opinion. The Court held that the summary of adjusted earnings was neither false nor misleading. The Court found that the summary was not a financial report to which ac-

counting principles and rules apply, but an accurate portrayal of exactly what it purported to be—"an approximation of what the Faggen Companies would earn through the elimination of certain expenses if the companies were publicly, rather than privately, owned" (Pet. A 6a). Nowhere does Petitioner mention, as the courts below observed, that there was neither a claim nor proof that there was any false or misleading statement in the historical financials incorporated into the definitive contracts which were represented by Respondent to be accurate and that on the trial each of the Petitioner's financial experts, as well as the lawyer who negotiated the deal on Petitioner's behalf, conceded that these financials were accurate in all respects (R. 254, 564, 654, 705).

POINT II

The acceleration of the debentures by virtue of the default in the payment of interest was proper.

In rejecting Petitioner's claim, Judge Tyler in a separate opinion (Pet. A 36a, et seq.) affirmed by the Court of Appeals (Pet. A 9a-10a) found that there was neither hidden interest nor a penalty in the debentures and that the debentures were therefore enforcable in accordance with their terms. There is no compelling reason to review that essentially factual determination.

Conclusion

The District Court found and the Court of Appeals affirmed that the Respondent was not guilty of any fraudulent misrepresentation or omission in connection with the transaction. The Petitioner would rewrite Rule 10b-5 and would reverse a host of authorities which require that a transaction be judged in light of all surrounding circum-

stances. Petitioner would eliminate causation in fact as a prerequisite to recovery. The courts below properly applied the requirements of Rule 10b-5 in making their factual determinations. There is no conflict among the Circuits on the issues raised. There is no reason for this Court to grant this Petition. The writ should be denied.

Respectfully Submitted,

BURTON S. COOPER
Attorney for Respondent

Of Counsel:

SHEIB, SHATZKIN & COOPER
EDWARD LABATON
JOEL C. FEFFER